



STATE BOARD OF EQUALIZATION

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February 17, 1995

BURTON W. OLIVER
Executive Director

Mr. D--- -, G---
W---, S---, G--- & R---
XXX --- --- Road
--- ---, CA XXXXX-XXXX

Dear Mr. G---:

This is in reply to your July 29, 1994 letter regarding the application of sales and use tax to the transfer of the software applications program, Q--- P---. You noted the following facts:

"N--- is in the business of developing, manufacturing, licensing and selling hardware and software products and technology.

"N--- recently purchased from B--- I---, Inc. ('B---'), among other things, the software application program 'Q--- P---' (including all versions and iterations, all object and source code and all related works of authorship, algorithms, data and know-how, interfaces and other technology and information related to Q--- P---) and several licenses to use other B--- software Programs (the 'Licensed Software') which are embedded in Q--- P--- and are necessary to operate the Q--- P--- program. Together Q--- P--- and the Licensed Software are referred to hereinafter as the 'Transferred Programs'.

"N--- made a lump-sum payment to B--- of approximately -- Hundred --- Million dollars (\$XXX,000,000) in exchange for the rights to the Transferred Programs.

"Starting approximately ten days prior to the closing date

of the purchase (June 24, 1994), B--- commenced transmitting the Transferred Program to N--- via electronic transmission to and through N---'s computer. No tangible media containing the Transferred Programs was or has been delivered to N--- by B---. Based upon Sales and Use Tax Regulation 1502(f)(i)(1) (sic), N--- believes that its receipt of the Transferred Program solely by remote telecommunications, exempts the purchase of the Transferred Program from California Sales and Use Tax.

"For technical reasons associated with N---'s plan to republish the Transferred Programs for sale to distributors and end-users, N--- would now like to take delivery from B--- of tangible media containing the Transferred Programs."

Given this information, you asked whether the transfer of the tangible media is nontaxable pursuant to Sales and Use Tax Regulation 1502, subdivision (f)(1)(B) which provides, in relevant part:

"Tax does not apply, however, to license fees or royalty payments that are made for the right to reproduce or copy a program to which a federal copyright attaches in order for the program to be published and distributed for a consideration to third parties, even if a tangible copy of the program is transferred concurrently with the granting of such right. Any storage media used to transmit the program is merely incidental."

We understand B---'s transfer of Q--- P--- to N--- was to grant N--- the right to reproduce and copy Q--- P--- in order to publish and sell the program (including the programs embedded in Q--- P---). If, pursuant to that contract, B--- transfers the tangible media at no further charge, tax does not apply to the transfer. However, under the facts you provide, B---'s transfer of the program by electronic means was for the purpose of transferring the encoded data to N--- in order for N--- to copy and sell the Q--- P--- program. B---'s transfer of tangible media at a date later than the original transfer is for N--- to make a functional use of the media rather than to merely transfer the right to reproduce; the transfer of the right to reproduce had already occurred. Therefore, if N--- makes a further payment to B---, we believe the transfer of the tangible media is subject to tax measured by B---'s charge for the media.

Your letter does not discuss the application of tax to the portion of the charge attributable to tangible personal property other than the storage media. As noted above, tax does not apply to B---'s transfer of a tangible copy of the program concurrently with the granting of the right to reproduce or copy the program in order for the program to be published and distributed for a consideration to third parties. The concurrent transfer of the storage media is incidental to the

granting of the right to copy and sell the program.

If, as part of the transaction, B--- transfers to N--- tangible personal property (e.g., camera ready artwork, special printing aids, engineering notes, written procedures), tax applies to the sale of that property. (See Navistar International Transportation Corp. v. State Board of Equalization (1994) 8 Cal.4th 868.) In the absence of a separately stated price for such tangible personal property, tax applies to the fair retail value of the tangible personal property transferred.

We hope this answers your questions; however, if you need further information, feel free to write again.

Very truly yours,

Ronald L. Dick
Senior Staff Counsel

RLD:sr
N---,ltr

cc: --- --- District Administrator - --